banco central Chile

# MONETARY POLICY MEETING

OCTOBER 2024

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## Monetary policy meeting No. 309, held on 16-17 October 2024.

Present: Rosanna Costa, Governor; Stepanka Novy, Vice-Governor; Alberto Naudon, Board member; Luis Felipe Céspedes, Board member; Claudio Soto, Board member.

Present the Finance Minister, Mario Marcel.

Also present: Luis Óscar Herrera, General Manager; Juan Pablo Araya, Legal Counsel and Attestor; Elías Albagli, Monetary Policy Division Director; Ricardo Consiglio, Financial Markets Division Director; Rosario Celedón, Financial Policy Division Director; Gloria Peña, Statistics and Data Division Director; Michel Moure, Institutional Affairs Division Director; Markus Kirchner, Macroeconomic Analysis Manager; Enrique Orellana, Monetary Policy Strategy and Communication Manager; Sofía Bauducco, Economic Research Manager; Guillermo Carlomagno, International Analysis Manager; Felipe Musa, Market Operations Manager; Miguel Fuentes, Financial Stability Manager; David Kohn, Head of Massive Information Analysis Department; Tatiana Vargas, Advisor to the Finance Minister; Erika Arraño, Senior Economist; Marlys Pabst, Secretary General.

## 1. Background

### The international scenario

The U.S. Federal Reserve (Fed) had launched its process of interest rate reductions, with a 50 basis point (bp) cut in September. This magnitude and the evolution of the labor market up to August had led the markets to expect further cuts in future meetings. This outlook had been reversed following the messages from the Fed and the publication of favorable economic figures. The greater dynamism of some labor market data stood out, mitigating concerns about an over-adjustment of the labor market. Meanwhile, inflation had exceeded expectations at the margin and second-quarter GDP showed robust activity, driven mainly by consumption.

The Chinese economy was still performing poorly according to partial third-quarter indicators, combiend with lower-than-expected inflation. In this context, the authorities had announced monetary, fiscal and financial stimulus measures, awaiting further details. The outlook for the Eurozone also pointed to a moderate performance, albeit with certain heterogeneities among sectors and countries. Inflation in the bloc had continued to decline, amid still tight labor markets, while the European Central Bank had applied another cut to its interest rate.

In Latin America, high-frequency indicators confirmed a somewhat more dynamic scenario compared with a few months back, and inflation continued to recede, although in most countries it remained above their respective target rates. Brazil was the exception, as accelerating inflation and the progressive de-anchoring of expectations had prompted a rise in the policy rate, contrasting with the rest of the region.

To a large extent, the international financial markets had been influenced by the evolution of the macroeconomy in the main economies and intensified geopolitical risks. Overall, the financial conditions concerning the emerging world had become more contractionary than they were at the time of the previous meeting, and somewhat more expansionary for the developed world. In particular, long-term interest rates had risen in an important group of countries in recent weeks and the dollar had appreciated against most currencies.

Commodity prices had seen swings associated with the same factors explaining the evolution of financial markets. In general, tensions in the Middle East had boosted oil prices since the end of September, an adjustment that had been reversing in the days prior to the meeting. Copper prices had risen since the last meeting, to record-highs since July, helped by the announcement of stimulus measures in the Chinese economy. In general, food prices had risen as a result of adverse weather events in various parts of the world.

## The domestic scenario

Headline inflation had declined to 4.0% in September (spliced benchmark series). This was a little less than assumed in the latest Monetary Policy Report (IPoM), owing to the behavior of the volatile items in the basket, mainly foodstuffs, followed by some fuels. Core inflation (i.e., the CPI without volatiles) stood at 3.8% annually, which was aligned with the September IPoM projections. One year out inflation expectations from the Economic Expectations Survey (EEE) and the Financial Traders Survey (EOF) had declined marginally but remained around 3% at two years.

Activity and demand indicators were performing in line with the September IPoM's central scenario. The August Imacec had seen a rise of 2.3% annually (-0.2% monthly, seasonally adjusted), influenced by the good performance of the mining industry. As in previous months, the result had been affected by one-off factors, in the context of significantly volatile monthly figures. On the expenditure side, high-frequency indicators relating consumption and investment showed relative stability in their latest data. The unemployment rate for the moving quarter ending in August had risen to 8.9%. Wages were beginning to move closer to their historical averages, after some months of accelerated growth.

The local financial market had been following international trends. Long-term interest rates had begun to rise after being on a declining path for some months. Compared with the previous meeting, the peso had depreciated and fluctuated consistently with the evolution of its fundamentals.

The MPR cuts continued to be transmitted to the interest rates on banking consumer and commercial loans. Bank credit was still weak, especially its commercial component, where real loans posted in September their

biggest contraction in the year to date (an annual change of –4.9%). The third-quarter Bank Lending Survey revealed that supply conditions had gained some flexibility in several credit categories, and that demand remained tight.

Respondents to the EEE and the EOF surveys expected the MPR to be lowered by 25 bp at this meeting, matching the prospects implicit in the prices of financial assets. In turn, the two surveys and the forward curve anticipated an MPR of 4.25% in one year.

# 2. Background analysis and discussion

The discussion touched on the latest developments in private consumption and its determinants. High-frequency data suggested that during the third quarter this expenditure component showed somewhat lower-than-expected growth. It was unclear whether this was due to weaker household spending, as its determinants showed no substantive changes. On the one hand, the wage bill continued on a similar expansion trajectory to previous quarters, combining a further increase in real wages with slowdown in job creation. On the other hand, a pass-through of the lower MPR to lending rates was observed, along with a reduction in the financial burden of households, in the context of still weak consumer credit. The role of fiscal spending was also mentioned, since, although private consumption could perform below expectations, the opposite was happening with government spending. In any case, it was noted that the evolution of consumption was something to continue to watch closely, in accordance with the upward and downward sensitivities considered by the MPR corridor depicted in the last IPoM.

The size of labor market gaps was also discussed, as it was a relevant issue when assessing the inflationary pressures that the economy could face. On the one hand, it was pointed out that the increase in the unemployment rate could be an indication of greater slack. On the other, it was mentioned that it was not clear how much of the increase in unemployment was due to cyclical factors and how much to structural factors. In addition, the potential impact of increased recruitment costs had to be considered. There was agreement that the level of the gap in the labor market needed to be elucidated, due to the importance of its implications for monetary policy.

About inflation, it was stressed that market expectations continued to reflect the transitory nature of their recent increase. However, scenarios in which inflation was more persistent than usual could not be ruled out, particularly because two significant increases in electricity rates had yet to be implemented and additional shocks could not be ruled out.

On the external front, the aggravation of geopolitical risks was highlighted, as were the difficulties in anticipating the scope of the conflict in the Middle East, in a context where the occasional Chinese military maneuvers around the island of Taiwan were also a source of tension and where the war in Ukraine was still unresolved.

Although geopolitical issues had had rather muted effects on global markets, these could possibly intensify in the face of further escalation. It also had to be considered that increased geopolitical risks could lead to a rise in uncertainty, even in the absence of any major military action. This could have effects on the world economy that could be passed on to the Chilean economy. It was also noteworthy that, in the face of the latest conflicts in the Middle East, global long-term interest rates had reacted upward, rather than downward as had been the case historically. This could be a sign of fiscal consequences via increased defense spending, in the context of high debt levels. There was agreement that the evolution of geopolitical risks and their implications for the macroeconomic scenario was a relevant issue to continue monitoring in view of the next IPoM.

## 3. Analysis of monetary policy options

All five Board members agreed that the information received since the last meeting confirmed the central scenario contained in the last IPoM. Domestic economic activity and demand showed no major differences with respect to forecasts. The September inflation rate had been somewhat lower than expected, although due to volatile factors. The external environment also offered no major news in the evolution of global activity and inflation. In terms of sensitivity scenarios, doubts about the evolution of the labor market continued to persist, in addition to the increase in geopolitical tensions around the world. Inflation expectations were still aligned with a scenario where the rise in inflation would be temporary and that it would converge to the 3% target over the two-year policy horizon.

In this context, all the Board members agreed that, beyond the existing risks, the central scenario of the last IPoM was still in full force and the MPR needed to be further reduced towards its neutral level. Consistent with strategy presented in the September Report, the Board estimated that the only plausible option was to reduce the MPR by 25 basis points.

There was agreement that the option of a 25 bp cut was not only consistent with the macroeconomic scenario, but was also tactically the most appropriate. It was a movement largely expected by the market, in line with the information previously published by the Board. In fact, the expectations of both economists and financial traders surveyed showed high consensus, with almost 100% of respondents foreseeing a reduction of 25 basis points.

## 4. Monetary policy decision

Governor Costa, Vice-Governor Novy and Board members Naudon, Céspedes and Soto voted to reduce the monetary policy interest rate by 25 basis points, to 5.25%.

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